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C O N F I D E N T I A L SECTION 01 OF 02 RIGA 000690

SIPDIS

TREASURY FOR WILLIAM LINDQUIST

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TAGS: EFIN ECON PGOV LG
SUBJECT: LATVIAN GOVERNMENT TAKES MAJORITY SHARE IN PAREX
BANK

Classified By: Ambassador Charles Larson, for Reasons 1.4 (b) and (d)

¶1. (U) Summary. On November 8, at an emergency Cabinet session, the Latvian government decided to buy a 51% stake in Parex Bank, Latvia's second-largest (and largest independent) bank, in order to keep the keep the firm out of bankruptcy. The GOL is to pay a nominal fee to the previous owners for the majority shares, and then pass those shares to the state-controlled Latvian Mortgage and Land Bank (Latvijas Hipoteku un Zemes Banka). The Mortgage and Land Bank will reportedly inject around 200 million Lats (USD $364 million) into Parex Bank to shore up Parex's finances, with these funds coming from the Latvian central bank. Parex faced a growing liquidity problem and in recent weeks had been looking for sources of cash. The bank was reaching the point where it would be declared insolvent by law, which would have been far costlie for the government. The government's intervention was necessitated by an unexpected run on bank deposits which further reduced liquidity, with Parex depositors reported pulling USD $108 million out in the days before the announcement. Reaction has been generally favorable from the Latvian financial community, and political reaction has been cautiously optimistic, though opposition parties are asking that the government provide more information to the Saeima (Parliament). End summary.

Averting Bankruptcy

¶2. (U) On the evening of November 8, the Latvian government announced that it would be taking a majority stake in Parex Bank, the country's largest independent bank, and second-largest overall. At a press conference following an emergency meeting of the Cabinet, PM Godmanis explained that the GOL would take the action in order to safeguard the Latvian financial system. Finance Minister Slakteris, also speaking at the press event, noted that the government faced the choice of either helping Parex or letting it pass into bankruptcy, which would cost the government "billions" (one estimate put the figure at USD $1.09 billion) in deposit insurance compensation. Such payouts would quickly deplete the government's deposit insurance fund, which stands at roughly 80 million Lats (USD $145 million). Amounts above that would come out of the already tight state budget. The Chair of Latvia's bank regulator, the Latvian Financial and Capital Markets Commission (FCMC), Irene Krumane, told us that the final cost of letting Parex go under could have reached USD $1.5 billion, when the assets of state pensions and state-run enterprises held in Parex were taken into consideration.

¶3. (C) The government's hand was forced by a surge of depositors taking their money out of Parex, as rumors spread about the bank's weakening financial situation. According to Krumane, the FCMC had Parex under watch since mid-August, for various reasons which included the bank's exposure to risky

securities, falling capital adequacy ratios and concern about potential fallout of the Russian invasion of Georgia, given Parex's high volume of non-resident deposits from Russia. In contrast to other banks which were managing declining assets over time, Parex was holding on to increasingly toxic assets from the U.S., U.K., Russia, and elsewhere. In the first week of November, the FCMC and government noticed a surge in deposits (both resident and non-resident) being withdrawn, which was putting Parex in danger of insolvency. The government determined that Parex was systemically important to the Latvian financial system, and in response to Parex's request for assistance, the government agreed to take controlling interest.

The Deal

¶4. (C) In the deal announced, Latvia will pay a nominal fee of 2 Lats (USD $3.64) to the two principal owners of Parex, Valery Kargin and Viktor Krasovicki, in exchange for 51% of Parex's shares. These shares will be passed to the Latvian Mortgage and Land Bank (Latvijas Hipoteku un Zemes Banka), which is the only state-controlled bank. The Mortgage and Land Bank will then inject approximately 200 million Lats (USD $364 million) into Parex to shore up the bank's finances. This money will come from the Bank of Latvia through the sale of bonds on the local market. In addition to transferring 51% of Parex shares to the government, Kargin and Krasovicki must pledge their remaining shares (they previously held a total of 84% of the bank's shares - 42% each) as security against the 200 million Lats from the

Mortgage and Land Bank, and according the FCMC, the two are also required to put their personal properties up as additional security. In effect, they are pledging their assets that the bank's situation is as they said, something Krumane doubted following recent audits. Kargin, who was Parex's Chairman of the Board, will be required to step down from that position, but both Kargin and Krasovicki will be retained as Board Members.

¶5. (C) Both Godmanis and Bank of Latvia Governor Ilmars Rimsevics have stated that there are no similar actions planned for other banks in Latvia, and this is supported by information provided to us by FCMC Chairperson Krumane. Rimsevics told the press that the GOL would not hold on to its controlling stake in Parex for long, with the Bank's press spokesman saying that the government would look to sell to strategic investors within a year or two. Krumane mentioned that the time frame would be at least six months.

Financial and Political Reaction

¶6. (U) Reaction to the deal has been generally positive. From the financial community, most experts have applauded the move as means of restoring faith in Parex bank and the overall Latvian financial system, and many have noted that with the nominal sum paid by the government, the financial pain falls on Parex's owners. Political reaction has been cautiously optimistic. Einars Repse, former Governor of the Bank of Latvia and Prime Minister who is currently an MP from the opposition New Era (Jaunais Laiks) Party, has urged the public to trust the government and the Bank of Latvia, though his party has asked that the government provide more information to the Saeima (Parliament). Similarly, the opposition party Civic Union has called on the government to explain to the Saeima how the government will ensure that state funds are used responsibly and to discuss how the deal will impact the state budget. However, there is no need for parliamentary approval of the deal. The European Commission offered its preliminary approval on November 10.

IMF Assistance

¶7. (C) We found opinion split on whether the takeover of Parex increases the likelihood that Latvia may need to approach the IMF for assistance. The Bank of Latvia told us that this does not change Latvia's position and that neither the Bank of Latvia nor the Economics Ministry have contemplated IMF assistance. However, Krumane at the FCMC, a former Treasurer of Latvia and State Secretary of the Finance Ministry, said she believes that the new circumstances definitely make it more likely that Latvia would need to seek help from the IMF.

Comment

¶8. (C) The government reaction has drawn generally positive reviews so far for being swift and decisive, and for ensuring that the owners did not get away scott-free (as happened in the Banka Baltija case of the mid-90's). In the coming days, we will need to keep an eye on how the decision is implemented. As one prominent newspaper editor told us today, the temptation to play politics with Parex - which has always been a political player in Latvia - will be high. The question is whether leaders can rise above that and hold firm to implementing this in a professional way.
LARSON